

THE OFFICE OF REGULATORY STAFF

**DIRECT REHEARING TESTIMONY &
EXHIBITS**

OF

DANIEL F. SULLIVAN

AUGUST 16, 2018



DOCKET NO. 2017-292-WS

**Application of Carolina Water Service, Incorporated for
Approval of an Increase in Its Rates for Water and Sewer
Services**

DIRECT REHEARING TESTIMONY AND EXHIBITS OF

DANIEL F. SULLIVAN

ON BEHALF OF

THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF

DOCKET NO. 2017-292-WS

**IN RE: APPLICATION OF CAROLINA WATER SERVICE,
INCORPORATED FOR APPROVAL OF AN INCREASE IN ITS
RATES FOR WATER AND SEWER SERVICES**

**Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND
OCCUPATION.**

A. My name is Daniel F. Sullivan. My business address is 1401 Main Street,
Suite 900, Columbia, South Carolina, 29201. I am employed by the South Carolina
Office of Regulatory Staff ("ORS") in the Audit Department as the Deputy
Director.

**Q. DID YOU PREVIOUSLY PRESENT DIRECT AND REVISED
SURREBUTTAL TESTIMONY IN THIS DOCKET?**

A. No. Zachary J. Payne filed direct testimony and revised surrebuttal
testimony reflecting ORS Audit Department's findings in this proceeding on March
12, 2018 and March 28, 2018, respectively.

**Q. WHAT IS THE PURPOSE OF YOUR DIRECT REHEARING
TESTIMONY?**

1 **A.** The purpose of my direct rehearing testimony is to describe the process
2 employed by the ORS Audit Department that led ORS to propose adjustment 9d to
3 normalize sludge hauling expenses for the Carolina Water Service, Inc. (“CWS” or
4 “Company”) Friarsgate and Watergate wastewater treatment plants and show the
5 results of ORS’s proposed rehearing adjustments.

6 **Q. WHAT WAS ORS’S PROCESS FOR DETERMINING THAT SLUDGE**
7 **HAULING EXPENSES FOR FRIARSGATE AND WATERGATE**
8 **WASTEWATER TREATMENT PLANTS SHOULD BE NORMALIZED?**

9 **A.** ORS’s initial review of a Company’s application involved obtaining the
10 trial balances for the test year and the previous two years. ORS then compared the
11 balances in each account for the test year with the balances in that account for the
12 previous two years. ORS then set threshold criteria for dollar increases and
13 percentage increases to identify accounts which ORS would request the Company
14 to provide explanations for the increases. For this docket, ORS set \$20,000 and
15 10% as the threshold criteria to identify accounts to request from the Company
16 explanations for the increases. ORS also judgementally selected additional
17 accounts that did not meet the threshold criteria to request explanations from the
18 Company for any increases. Account #6410 Sludge Hauling Expense increased
19 \$150,555 or 76% from 2016 to 2017, and therefore, was identified as an account
20 with an increase meeting the threshold criteria. ORS requested the Company to
21 provide an explanation for the increase in sludge hauling expense. The Company’s
22 response was that sludge hauling expense had increased partially due to control of
23 the Friarsgate wastewater treatment facility sludge inventory at the plant and that

1 sludge hauling expense was also being addressed through CWS's inflow &
2 infiltration ("I&I") capital project on the Friarsgate collection system. ORS further
3 analyzed the sludge hauling expense account and identified the Friarsgate and
4 Watergate business units ("BUs") as the primary BUs responsible for the increase
5 in sludge hauling expense. It was ORS's opinion that the test year sludge hauling
6 expense amounts were atypical, and did not indicate future trends. Based on the
7 review, ORS noted the following for the Friarsgate and Watergate BUs:

Annual Sludge Hauling Expense for Friarsgate and Watergate				
	Expense for 12 Months Ended 8/31/15	Expense for 12 Months Ended 8/31/16	Expense for 12 Months Ended 8/31/17	3 Year Average Annual Expense
Friarsgate	\$99,197	\$127,426	\$212,226	\$146,283
Watergate	\$25,370	\$25,797	\$72,007	\$41,058

8 ORS used the three year average annual expense (shown in the table above) to
9 calculate ORS adjustment 9d of (\$96,892). The purpose of this adjustment was to
10 normalize the expense to more closely reflect sludge hauling expenses in a typical
11 year, and thus normalize the Company's operating experience. In applying
12 normalization, ORS is following a principle recognized by the South Carolina
13 Supreme Court as appropriate in situations such as in the present case. In *Porter v.*
14 *South Carolina Public Service Comm'n*, 328 S.C. 222, 493 S.E.2d 92 (1997) the
15 Court stated that "when an unusual situation exists for utility ratemaking purposes
16 resulting in test year figures that are atypical and thus do not indicate future trends,
17 Public Service Commission ("PSC") should adjust test year data."

Q. ARE THERE OTHER MANUALS OR INSTRUCTIONS THAT SPECIFY WHEN TO USE NORMALIZATION ADJUSTMENTS?

A. Yes. "Accounting for Public Utilities" written by Hahne and Aliff specifically addresses normalization in Chapter 7, section 7.05, Pro Forma Adjustments to the Test Year Data. One type of normally utilized pro forma adjustments are normalizing adjustments. Normalizing adjustments are made to restate balances during the period for abnormal conditions. Normalization adjustments are usually made to revenues or expenses to offset for unusual operating events that are extraordinary and have a non-recurring impact on utility operations.

Q. IS IT ORS'S OPINION THAT SLUDGE HAULING EXPENSES AT FRIARSGATE AND WATERGATE DURING THE TEST YEAR WERE ABNORMAL AND NON-RECURRING?

A. Yes. Based on the significant increase in sludge hauling expenses and atypical operating circumstances, ORS determined that test year sludge hauling expenses for both the Friarsgate and Watergate wastewater treatment facilities were abnormal. ORS was aware that CWS was under South Carolina Department of Health and Environmental Control consent orders for both the Friarsgate and Watergate wastewater treatment facilities during the test year. Work was also being performed on the equalization basin at the Friarsgate wastewater treatment facility which involved removal of large amounts of sludge. Additionally, a capital project had been established during the test year aimed at correcting I&I issues for the Friarsgate collection system. The consent orders, work on the Friarsgate

equalization basin, and the Friarsgate I&I project were considered non-recurring and contributors to the increase in sludge hauling expense for the test year. ORS recognized that absent the consent orders or work performed on the Friarsgate system there would continue to be sludge hauling expenses at both the Friarsgate and Watergate wastewater treatment facilities, and therefore, ORS averaged the previous three years of sludge hauling expense to calculate the ORS proposed adjustment.

Q. SUBSEQUENT TO THE APRIL 2018 HEARING IN THIS DOCKET, HAS ORS RECEIVED ADDITIONAL INFORMATION TO FURTHER DEMONSTRATE THE NEED FOR SLUDGE HAULING EXPENSE TO BE NORMALIZED?

A. Yes. The Company filed an application with the PSC on August 2, 2018, for approval of a sanitary wastewater interconnection agreement between CWS and the City of Columbia for the Friarsgate wastewater treatment facility.

Q. DID YOU PREPARE ANY EXHIBITS FOR THE REHEARING?

A. Yes. I prepared Rehearing Audit Exhibit DFS-1 and Rehearing Audit Exhibit DFS-2 that shows the results for the inclusion of ORS's adjustment for sludge hauling expenses as discussed as part of this testimony, and ORS's adjustment for litigation expenses and the equalization basin, as discussed in the testimony of ORS witness Dawn M. Hipp. All other adjustments, besides the calculation of fall-out adjustments and the ORS proposed rehearing decrease, are the adjustments included in PSC Order No. 2018-345(A).

**Q. WHAT WOULD BE THE EFFECT ON THE COMPANY'S REVENUES IF
THE PSC WERE TO ACCEPT THE ORS PROPOSED REHEARING
ADJUSTMENTS?**

A. Rehearing Audit Exhibit DFS-1 shows that the result of ORS's proposed rehearing adjustments based on the PSC approved return on equity of 10.5% would be a net reduction to revenues for the Company of \$127,156.

Q. DOES THIS CONCLUDE YOUR REHEARING TESTIMONY?

A. Yes.

Carolina Water Service, Inc.
Operating Experience, Rate Base and Rate of Return
Combined Operations
Docket No. 2017-292-WS
Test Year Ended August 31, 2017

Description	(1) Per PSC Order No. 2018-345(A) \$	(2) ORS Rehearing Adjustments \$	(3) After ORS Rehearing Adjustments \$	(4) ORS Proposed Rehearing Decrease \$	(5) After ORS Rehearing Decrease \$
<u>Operating Revenues</u>					
Service Revenues - Water	12,092,771	-	12,092,771	-	12,092,771
Service Revenues - Sewer	10,591,452	-	10,591,452	(127,500) (K)	10,463,952
Miscellaneous Revenues	527,899	-	527,899	(1,540) (L)	526,359
Uncollectible Accounts	(338,928)	-	(338,928)	1,884 (M)	(337,044)
Total Operating Revenues	22,873,194	-	22,873,194	(127,156)	22,746,038
<u>Maintenance Expenses</u>					
Salaries and Wages	2,699,723	-	2,699,723	-	2,699,723
Capitalized Time	(541,688)	-	(541,688)	-	(541,688)
Purchased Power	820,160	-	820,160	-	820,160
Purchased Water and Sewer	3,927,915	-	3,927,915	-	3,927,915
Maintenance and Repair	2,328,889	(96,892) (A)	2,231,997	-	2,231,997
Maintenance Testing	256,619	-	256,619	-	256,619
Meter Reading	110,180	-	110,180	-	110,180
Chemicals	399,940	-	399,940	-	399,940
Transportation	205,565	-	205,565	-	205,565
Operating Exp. Charged to Plant	0	-	0	-	0
Total Maintenance Expenses	10,207,303	(96,892)	10,110,411	-	10,110,411
Salaries and Wages	627,460	-	627,460	-	627,460
Office Supplies & Other Office Exp	304,108	-	304,108	-	304,108
Regulatory Commission Exp.	138,929	(14,979) (B)	123,950	-	123,950
Pension & Other Benefits	819,258	-	819,258	-	819,258
Rent	25,402	-	25,402	-	25,402
Insurance	292,007	-	292,007	-	292,007
Office Utilities	540,417	-	540,417	-	540,417
Outside Services	272,599	-	272,599	-	272,599
Non-Utility Misc Income	0	-	0	-	0
Miscellaneous	(80,508)	-	(80,508)	-	(80,508)
Total General Expenses	2,939,672	(14,979)	2,924,693	-	2,924,693
Depreciation	1,634,435	(1,377) (C)	1,633,058	-	1,633,058
Amortization of CIAC	(405,850)	-	(405,850)	-	(405,850)
Taxes Other Than Income	3,042,436	-	3,042,436	(669) (N)	3,041,767
Income Taxes - State	188,283	5,663 (D)	193,946	(6,324) (O)	187,622
Income Taxes - Federal	614,357	22,593 (E)	636,950	(25,234) (P)	611,716
Sale of Utility Property	-	-	0	-	0
Amort. Investment Tax Credit	(8,853)	-	(8,853)	-	(8,853)
Amortization of PAA	(15,373)	-	(15,373)	-	(15,373)
Total Other Expenses	5,049,435	26,879	5,076,314	(32,227)	5,044,087
Total Operating Expenses	18,196,410	(84,992)	18,111,418	(32,227)	18,079,191
Net Operating Income	4,676,784	84,992	4,761,776	(94,929)	4,666,847
Customer Growth	62,269	1,132 (F)	63,401	(1,264) (Q)	62,137
Interest During Construction	-	-	0	-	0
Net Income (Loss) For Return	4,739,053	86,124	4,825,177	(96,193)	4,728,984
<u>Original Cost Rate Base:</u>					
Gross Plant In Service	96,559,114	(91,785) (G)	96,467,329	-	96,467,329
Accumulated Depreciation	(12,988,919)	1,377 (H)	(12,987,542)	-	(12,987,542)
Net Plant In Service	83,570,195	(90,408)	83,479,787	-	83,479,787
Deferred Charges	0	-	0	-	0
Cash Working Capital	1,620,963	(13,984) (I)	1,606,979	-	1,606,979
Contributions In Aid of Construction	(20,930,124)	-	(20,930,124)	-	(20,930,124)
Accumulated Deferred Income Taxes	(7,539,472)	-	(7,539,472)	-	(7,539,472)
Customer Deposits	(336,522)	-	(336,522)	-	(336,522)
Advances in Aid of Construction	0	-	0	-	0
Plant Acquisition Adjustment	(860,085)	-	(860,085)	-	(860,085)
Total Rate Base	55,524,955	(104,392)	55,420,563	-	55,420,563
Return on Rate Base	8.53%		8.71%		8.53%
Operating Margin	13.23%		13.62%		13.27%
Interest Expense	1,713,755	(3,315) (J)	1,710,440	0	1,710,440

Carolina Water Service, Inc. - Docket No. 2017-292-WS
Explanation of ORS Rehearing Adjustments
Test Year Ended August 31, 2017

Rehearing Audit Exhibit DFS-2

Adj #	Description	Operating Revenues	Miscellaneous Revenues	Uncollectible Accounts	Maintenance and Repair	Regulatory Commission Expense	Depreciation	Taxes Other Than Income	Income Taxes - State	Income Taxes - Federal	Customer Growth	Gross Plant In Service	Accumulated Depreciation	Cash Working Capital	Interest on Debt
		\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$

ORS Rehearing Adjustments

1	To normalize sludge hauling expenses.				(96,892)				4,845	19,330	968			(12,112)	(385)
2	To remove the amortization of litigation expenses.					(14,979)			749	2,988	150			(1,872)	(59)
3	To adjust the environmental component of the Friarsgate wastewater treatment plant equalization basin.						(1,377)		69	275	14	(91,785)	1,377		(2,871)
Total ORS Rehearing Adjustments		-	-	-	(96,892)	(14,979)	(1,377)	-	5,663	22,593	1,132	(91,785)	1,377	(13,964)	(3,315)
		(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)	(L)	(M)	(N)

ORS Proposed Rehearing Decrease

4	Adjust Revenue, Taxes & Customer Growth for the ORS Rehearing Decrease	(127,500)	(1,540)	1,884				(669)	(6,324)	(25,234)	(1,264)				-
Total ORS Proposed Rehearing Decrease		(127,500)	(1,540)	1,884	-	-	-	(669)	(6,324)	(25,234)	(1,264)	-	-	-	-
		(K)	(L)	(M)	(N)	(O)	(P)	(Q)	(R)	(S)	(T)	(U)	(V)	(W)	(X)